



Millions of School Dollars Hinge on Result of *CTA vs. Gould*

The end could be near in one of the longest-running legal battles over school finance in California history. Then again, maybe not.

The case, *California Teachers Association vs. Gould* (Calif CtApp, 3rd Dist, No. 3 Civil CO18447, 5/1/95), is a multimillion-dollar dispute over school funding — money supposedly guaranteed by the landmark 1988 constitutional amendment, Proposition 98.

Words like "vastly complicated" and "incredibly complex" pepper legal briefs filed by all sides in *CTA vs. Gould*, a dispute over whether California's schools have to pay back funds — provided to them under Proposition 98 — that were later determined to be a "loan," because of state revenue shortfalls.

Voter-initiated, Proposition 98 (as subsequently amended in 1990 by Proposition 111) guarantees K-12 schools and community colleges a stable, minimum level of annual funding tied to growth in the state's General Fund revenues, inflation, and increases in student enrollment. Except in fiscal emergencies, the propositions are designed to increase education funding every year, based on the previous year's level of funding.

That funding mechanism unraveled in the early 1990s when California was hit by the worst recession since the Great Depression. In the eyes of the education community, the governor and the Legislature reneged on \$1.083 billion of Proposition 98 funding in the 1991-92 state budget, so CTA and others sued the state in superior court Nov. 9, 1992.

Over the years, the case evolved into what is now known as *CTA vs. Gould*.

The California Department of Education (CDE), the California School Boards Association (CSBA) and several individuals are also party to the highly technical and complex suit against the Department of Finance (DOF) and the State Controller's Office.

Lawsuits are generally identified by the names of the principals of the agencies being sued at the time the suit is filed. In this case, the individuals were former DOF director Russell S. Gould and former State Controller Gray Davis. (Craig L. Brown is the

current director of DOF and Kathleen Connell (D) is now state controller.)

Attorney General Dan Lungren (R) is currently representing the state in this matter.

After losing an initial legal skirmish (*CTA vs. Hayes*), CTA won a partial victory in Sacramento Superior Court April 26, 1994. The state appealed the decision Oct. 14, 1994, to the 3rd District Court of Appeals in Sacramento. CTA, CSBA and Superintendent of Public Instruction Delaine Eastin (for CDE) cross-appealed Jan. 27, 1995.

To date, six briefs have been filed with the appellate court, but the case has yet to be heard by the court. Instead, "in the context of last year's budget settlement, the parties agreed to seek a settlement and have it blessed, as it were, by the appellate court," CDE Fiscal Policy Director James Wilson told *CEFA*.

"The settlement's still on course," according to H.D. Palmer, assistant director of DOF. "The lawyers are working on the fine print. We anticipate and hope that we will be able to reach a resolution fairly shortly," he said.

Others are less sanguine about an imminent settlement. They did note, however, that the negotiators are under a "hell of a lot of pressure" from the appellate court to come to consensus, and "there is incentive on both sides to bring these issues to closure as soon as possible."

[*Ed. note: Several sources spoke to CEFA only on condition of anonymity. The settlement participants are negotiating under a self-imposed gag order.*]

"The negotiations are very delicate," CTA spokeswoman Tommye Hutto confirmed, adding that the teachers' association does not want to jeopardize the talks by speaking out now.

The putative deadline for settlement is Aug. 1 of this year, when \$360 million in a "hostage" account, set aside in the 1995-96 budget, is scheduled to be released to schools — contingent on the settlement of the lawsuit. (continued on page 7)

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However, much more is at stake: \$1.76 billion, according to the finance department.

Furthermore, the settlement of the case itself may trigger a return to the trial court on a constitutional issue that can only be addressed after the settlement is finalized, according to CTA.

What Happened?

In the 1991-92 state budget, the governor and Legislature inadvertently appropriated \$1.083 billion more for education than the minimum required by Proposition 98.

This happened because of a major shortfall in forecasted General Fund revenues.

"The level of funding necessary to meet the Proposition 98 minimum funding guarantee in any given year cannot be determined precisely at the beginning of a fiscal year," the attorney general notes in his Oct. 14, 1994, appellate court brief. "The guarantee can only be estimated initially, based, in part, on forecasts of enrollment and revenue."

Facing even worse financial straits the next year, Gov. Wilson and the Legislature set a record deadlock over the 1992-93 budget, not coming to agreement until Sept. 2, 1992 — two months after the constitutional July 1 budget deadline.

One of the most contentious issues was the \$1.083 billion "overappropriation" in the 1991-92 budget. "... the Legislature and governor did not want to include the \$1.083 billion ... for the purposes of calculating the 1992-93 (Proposition 98) minimum guarantee," CTA states in its Jan. 27, 1995, appellate brief.

"Nor," the brief continues, "did they want to suspend Proposition 98 for 1992-93, an available but politically unattractive option." (To suspend Proposition 98 for a year because of a fiscal emergency requires a two-thirds vote of both houses and the signature of the governor.)

Instead, the governor and the Legislature ultimately came to terms in SB 766, a so-called "trailer bill" to the 1992-93 budget in which "the state purported to retroactively recharacterize the \$1.083 billion in funding from the previous year [1991-92] as having been a 'loan' to schools for that year ...

"The state theorized that as a loan, the funds were not a permanent allocation and thus need not be counted as part of the 'total monies allocated to school districts' for the purposes of calculating the minimum guarantee for 1992-93," CTA argues in its opening brief.

Moreover, SB 766 required schools "to pay back the \$1.083 billion 'loan' out of their 1992-93 Proposition 98 funding."

Viewing this as a \$2.2 billion "double hit" on 1992-93 education funding, CTA and its co-litigants sued the state.

Nevertheless, the governor and Legislature came to a similar budget resolution the following year (1993-94) in another trailer bill, SB 399. This time the "loan" was \$190.2 million — and CTA et al. sued again.

Although stating it differently, the attorney general appears to agree with CTA's conclusions: "The governor ... insisted on using the loan and repayment method, which have excluded the extra funds from the calculation of the Proposition 98 guarantee in future years, to ensure that the state's obligation under Proposition 98 was as low as possible."

Likewise, "... it was the Legislature's intent to avoid increasing the state's obligation under Proposition 98," the attorney general's 1994 appellate brief explains.

[Ed. note: For the sake of clarity and brevity, this analysis is limited to the major issues of the case. It does not address such matters as additional "emergency loans" of \$973 million and \$786.7 million made to maintain previous-year per-pupil levels of spending or complications created by a midstream shift in property tax allocations.]

Win Some, Lose Some, Work It Out

Although the state teachers' association ostensibly "won" its case in Superior Court April 26, 1994, both sides appealed the decision, albeit for different reasons.

Superior Court Judge James T. Ford ruled that the "loans" were "unconstitutional, unenforceable, and invalid." The schools, therefore, could not be required to pay them back. The ruling was a victory for Proposition 98 and the education community.

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On the other hand, the court did not allow the \$1.083 billion and \$190.2 million excess appropriations to be counted in the Proposition 98 base for the purpose of calculating subsequent years' minimum funding guarantees.

CTA and company are arguing for the excess appropriations to be included in the Proposition 98 funding base. "An appropriation is an appropriation is an appropriation." And, they reason in their Jan. 27, 1995, brief, that according to Article XVI, Section 8 of the California Constitution, "appropriations must be counted in the year that they are authorized in order to calculate the next year's Proposition 98 minimum funding guarantee."

Meanwhile, the state argues another constitutional point in its opening brief: "The superior court's action is tantamount to rewriting the appropriation of the Legislature, and therefore ... violates the separation-of-powers doctrine."

Rather than throw themselves on the mercy of a three-judge appellate panel, both sides agreed, as part of the 1995-96 budget agreement, to present a negotiated settlement to the court for its imprimatur.

Although the litigants are still dickering over the technical details, documents supplied to *CEFA* by DOF and CDE list the following key provisions of the proposed settlement:

- **Loan repayment** - K-14 schools and the state will share the cost of retiring the \$1.76 billion loan liability over a period of eight years. Starting in fiscal year 1994-95, schools will make a loan repayment of \$50 million on an escalating schedule that tops out at \$125 million a year until \$825 million is paid off.

For its part, starting in FY 1996-97, the state will provide schools with \$50 million above what is the current Proposition 98 guarantee. That annual amount will rise to \$225 million over the guarantee, for a total of \$935 million.

- **Maintenance factor** - The state agrees to add \$275 million, "when it is affordable," to the Proposition 98 "maintenance factor." The maintenance factor is the mechanism by which the Proposition 98 funding base is eventually restored over time when, in any given year, the Proposition 98 minimum guarantee is not fully funded because of fiscal shortfalls.

- **One-time funding** - The state will spend more than \$543 million in FY 1994-95 dollars for such one-time expenses as educational materials, deferred maintenance, educational technology and other non-recurring costs.

- **Hostage release** - Contingent upon settlement of the lawsuit, \$360 million of FY 1995-96 school monies held in the "hostage account" will be released Aug. 1 of this year for general-purpose funding, such as district and county office of education equalization. Also, some of the funds are earmarked for specified categorical programs.

- **No more loans** - The state agrees not to use the loan-and-recapture stratagem in the future, and the schools will not seek any amounts that might still be "owed" to schools from the years prior to 1994.

- **Prior year certification** - The state agrees to "certify" (i.e., close the books) on all prior-year Proposition 98 amounts through FY 1994-95. Certification could be one of the most challenging tasks facing the settlement negotiators, because as one of the litigants understated: "In school finance, nothing is simple."

A Bitter Pill to Swallow

Assuming the litigants reach an out-of-court settlement and obtain ratification from the court of appeal, there is still one issue that may yet be remanded to the trial court for further disposition.

Anticipating a constitutional challenge, the authors of the SB 766 and SB 399 trailer bills wrote in provisions — termed "poison pills" by CTA — that stipulate if an appellate court finds the bills unconstitutional, Proposition 98 will automatically and retroactively be suspended under the fiscal emergency escape clause provided by the Legislature's Proposition 111 constitutional amendment to the electorate's Proposition 98.

Suspending Proposition 98, as provided for in the California Constitution, is precisely what the governor and Legislature should have — and could have — done in the first place, according to CTA.

Now, however, CTA appears poised to challenge the constitutionality of a retroactive suspension of Proposition 98 — just as soon as everybody agrees how the numbers add up in *CTA vs. Gould*.

- Tom Durkin +